

Insight and analysis for
the business tax community

TAX JOURNAL

Published by Tolley

Issue 1221 • 20 June 2014

The EC's new state aid investigations

Examining the wider implications

Jonathan Schwarz • Barrister •
Temple Tax Chambers



ANALYSIS

Turning back the clock on tax avoidance

Simon Yeo & Billal Malik • KPMG

The latest developments on private client taxes

Andrew Goldstone & Victoria Howarth • Mishcon de Reya

BEPS: possible EU law issues

Peter Cussons • Partner • PwC

Where are we now on pensions reform?

Paul Howard • Director • Gabelle

Tribunal rule 18 difficulties

Adam Craggs & Nick Fernyhough • RPC

COMMENT

£9m goes West

Simon McKie • Partner • McKie & Co

ASK AN EXPERT

FRS 102 and business combinations

Richard Jones • Tax technical senior manager • BDO

IN BRIEF

- VAT: why a policeman's lot is not a happy one
- UK tax attractiveness: is the job done?



Jonathan Schwarz
Barrister, Temple
Tax Chambers
Email: jonathan.
schwarz@
taxbarristers.com

The European Commission has opened state aid investigations into the transfer pricing arrangements of Apple (Ireland), Starbucks (the Netherlands) and Fiat Finance and Trade (Luxembourg) (see www.bit.ly/1hHXaM3).

How does state aid affect taxation?

Any selective aid – granted by a member state or through state resources in any form whatsoever – which distorts or threatens to distort competition by favouring certain undertakings, affecting trade between member states, is incompatible with the internal market (Treaty on the Functioning of the European Union (TFEU), article 107(1)). Such aid may be given through the tax system in the form of tax allowances, tax base reductions or other forms of tax advantage. The Commission's views on the application of the state aid rules to direct business taxation were set out in a notice ('Commission notice on the application of the state aid rules to measures relating to direct business taxation', *Official Journal of the European Communities* C 384, 10 December 1998), following the Code of Conduct for business taxation of the Council of Economics and Finance Ministers (ECOFIN) of 1 December 1997.

What exactly is the Commission investigating?

The European Commission will examine the following three transfer pricing arrangements agreed by tax administrations:

- Irish rulings affecting the profits of Apple Sales International and of Apple Operations Europe;
- Dutch ruling on the tax base for manufacturing activities of Starbucks Manufacturing EMEA BV; and
- Luxembourg ruling on the tax base for financing activities of Fiat Finance and Trade.

The Commission is not questioning the tax regimes of the three member states concerned, nor in principle is it questioning tax rulings or advance pricing agreements (APAs). However, it says that tax rulings or APAs that are used to provide selective advantages to a specific company or group of companies may involve prohibited state aid.

What will happen next?

If the Commission finds that aid granted by a state or through state resources is incompatible with the internal market, or that such aid is being misused, the Commission must require the state to abolish or alter such aid within a specified time. If the state concerned does not comply, the Commission or any other interested state may refer the matter to the CJEU (TFEU, article 108)

The Commission has already observed that the quality and consistency of the scrutiny by the tax authorities differs substantively across member states. It does not expect to encounter systematic rulings irregularities in the Netherlands which, it says, seems generally to proceed with a thorough assessment based on comprehensive information required from the taxpayer. At this stage, the Commission has concerns that the *Starbucks* ruling provides a selective advantage, because there are doubts whether it is in line with a market-based transfer pricing assessment.

In Ireland, the Commission notes that although the transfer pricing rules have been tightened over the years, the tax administration had a significant

degree of discretion in the past. The Commission has concerns that such discretion has been used to grant a selective advantage to Apple. The Commission notes, however, that the number of transfer pricing arrangements on which rulings have been issued in Ireland is limited.

Unlike the Netherlands and Ireland, Luxembourg has only provided the Commission with a limited sample of the information requested, but not the complete information demanded by the Commission. The Commission has therefore initiated infringement proceedings against Luxembourg by issuing formal notice.

What does the Commission approach signal for transfer pricing in the EU?

EU transfer pricing law – as reflected in article 4 of the EU Arbitration Convention, as based on article 9(1) of the OECD Model Convention – permits member states to adjust actual profits resulting from related party transactions upwards, if those transactions are not at arm's length. The Commission contends that if profits are based on remuneration that falls short of market terms, it could imply a more favourable treatment of the company compared to the treatment other taxpayers would normally receive under the member state's tax rules and that this may constitute state aid. If sustained by the CJEU, the right of member states to adjust related party profits upwards would become an obligation under EU law.

Almost all transfer pricing disputes are resolved by agreement. If the EU competition authorities have surveillance rights over the transfer pricing compliance activity of the national tax administrations, this may encourage less settlement. National tax administrations may instead prefer to see questions resolved by the courts, particularly in cases involving unique intangibles or high risk.

Will settled intra-group transactions be affected?

The Commission's investigations are into transfer pricing rulings on individual transactions. If they constitute unlawful aid, the Commission may require the member state to recover the aid from the beneficiary, unless recovery would be contrary to a general principle of Community law (see Commission's notice C 384 (referred to above), pp 3–9, article 14). Unlawful past transfer pricing arrangements agreed with tax authorities could thus be subject to clawback of tax with interest. Groups that have benefited from similar tax rulings may wish to review those rulings in light of these investigations in the context of the state aid rules.

Does the investigation foreshadow action in the UK and other member states?

The Commission has announced a wider enquiry of more member states tax rulings, in parallel to these three investigations as part of the EU Commission action in connection with base erosion and profit shifting. Starbucks' UK licensing arrangements, for example, have featured in the media, including a revision to its royalty rate agreed with HMRC. Representations from potentially affected parties, both state and private, will be considered by the Commission. A finding in principle that accepting non-arm's length pricing intra-group transactions is unlawful state aid will affect all member states.